

Redemption of a hotel chain's "rewards points" for stay at one of its hotels is not subject to Hotel Operators' Tax liability. See 35 ILCS 145/1 et seq. (This is a PLR.)

October 6, 2005

Dear Xxxxx:

This letter is in response to your letter dated October 8, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling is bifurcated as to the issues raised in your request and will bind the Department only with respect to CLIENT for issue number one related to "reward points," and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither CLIENT nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

On behalf of our client, CLIENT (hereinafter referred to as 'CLIENT' or 'our client'), we respectfully request the issuance of a private letter ruling by the Illinois Department of Revenue pursuant to 2 Ill. Adm. Code 1200.110.

General Information

1. Enclosed please find an original Form IL-2848 Power of Attorney, authorizing FIRM to represent CLIENT before the Illinois Department of Revenue ('the Department').
2. This Private Letter Ruling ('PLR') is not requested with regard to hypothetical or alternative proposed transactions. This PLR is requested to determine the Hotel Operators' Occupation Tax consequences of the actual business practice of CLIENT.

3. CLIENT is not currently engaged in litigation with the Department with regard to this or any other tax matter.
4. The Department has not previously ruled regarding this matter for CLIENT. Neither CLIENT nor FIRM has submitted the same or similar issue to the Department on behalf of CLIENT.
5. CLIENT requests that certain information be deleted from the PLR prior to dissemination to others. CLIENT requests that its name and the name of any and all related entities be deleted.
6. CLIENT knows of no authority contrary to the authorities referred to and cited below.

Statement of Facts

The taxpayer is a STATE company that owns and operates hotels nationwide. A number of these hotels are located in the State of Illinois.

I. Hotel Rewards Points Program

CLIENT operates a rewards program for frequent guests at its hotels. The program gives these frequent customers reward points for each stay at one of CLIENT's hotels. When a guest pays for a room at one of CLIENT's hotels, the guest earns points. These points can be exchanged in advance for complimentary lodging. The points have no dollar value to a hotel guest that receives and accumulates them. The recipient cannot resell the points on the open market, nor can the points be exchanged with one of the taxpayer's hotels for money. The points are non-transferable to other parties or individuals, with the exception of individuals living in the same household.

All of the taxpayer's hotels, whether owned, managed, or franchised, are required to participate in this reward points redemption program by terms of their management agreement. Each hotel pays approximately 4% of room revenues from the guests who are members of the point redemption program into a central reward point program fund every month. Thus, when a guest earns points from a stay at the hotel, the hotel will remit 4% of the room rate into the central reward point program fund.

The reward point program fund ('Fund') is not a separate legal entity nor is it affiliated with any entity. It is a segregated bank account, maintained under the name of taxpayer as agent for the hotels owned, leased, operated, managed or franchised by it, its subsidiaries, and/or affiliates. A division of the taxpayer has a dedicated staff that manages the Fund. The cost of administering the Fund is paid from the monies contributed by each hotel.

When a guest redeems points for a complimentary night's stay at our client's hotel, that particular hotel's reward Fund account is credited a certain amount to cover that guest's stay at the hotel. The amount credited offsets the amount the hotel contributes to the Fund for the month to cover the administrative costs of the Fund. The money contributed to, and held by, the Fund is held on behalf of each individual hotel in proportion to its monthly payments to the Fund. Each

hotel has a Fund balance related directly to its contributions and credits. In the event that the points redemption program is ever discontinued, the remaining balance of the Fund would revert back to each hotel according to the balance in each individual account within the Fund.

The staff managing the Fund handles all reward point redemption reservations. To redeem points for a complimentary stay, members must contact a central awards reservation desk set up specifically for the program. No guest can make arrangements directly with an individual hotel to redeem points for a complimentary stay. The awards desk makes the reservation for the member and then issues an electronic confirmation to the member. Each award confirmation has a unique award number. When the guest checks into the hotel, the guest will provide the hotel with the award number.

Each hotel is compensated for redemptions based on the daily total occupancy for each day of the award stay. Award compensation is reported via e-mail to hotels the third week of each month. The compensation report reflects all awards redeemed at that hotel for the prior month. Total award compensation for the month will be subtracted from the Assessment Invoice total in order to determine the net amount of payment from the hotel to the Fund for the month. In instances where compensation is greater than the amount owed by the hotel to the Fund for the month, the amount will be added to the hotel's account.

II. Early Departure Charges

Early departure charges are imposed when a guest makes a reservation for a number of nights, but then does not stay for the full number of nights of the reservation. For example, a guest makes a reservation at a hotel for three nights. After the first night, the guest leaves the hotel and does not stay for the remaining two nights. In such a situation, the hotel will impose a fee of \$50 or some similar amount that is less than the nightly room rate as an early departure charge.

Illinois Law and Rules Governing the Taxation of the Rental of Rooms in Hotels and Motels

The Hotel Operators' Occupation Tax Act ('the HOOT') (35 ILCS 145/1 *et seq.*) is imposed upon persons engaged in the business of renting, leasing or letting rooms in a hotel. The tax is imposed on the gross rental receipts from such renting, leasing or letting, (35 ILCS 145/3)

Section 2 of the HOOT sets forth definitions of various terms. The term 'hotel' means:

. . . any building or buildings in which the public may, for a consideration, obtain living quarters, sleeping or housekeeping accommodations. The term includes inns, motels, tourist homes or courts, lodging houses, rooming houses and apartment houses.

Section 2 of the HOOT also defines the term 'occupancy.' The term 'occupancy' means:

. . . the use or possession, or the right to the use or possession, of any room or rooms in a hotel for any purpose, or the right to use or possession

of the furnishings or to the services and accommodations accompanying the use and possession of the room or rooms.

In addition, Section 2 of the HOOT defines the term 'rent.' The term 'rent' means:

. . . the consideration received for occupancy, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property or services of any kind or nature.

The Department has adopted rules governing the HOOT at 86 Ill. Adm. Code 480. Section 480.101 of the Department's rules sets forth rules governing the nature, rate and scope of the tax. Section 480.101(b)(1) provides:

Since the Hotel Operators' Occupation Tax is imposed on receipts from renting rooms for living quarters, or for sleeping or housekeeping accommodations, the tax does not apply to the receipts from the renting of rooms for other purposes, such as for the use as display rooms or sample rooms, as meeting rooms, as offices or as private dining rooms.

Section 480.101(b)(6) prohibits taxpayers from separating out charges associated with the rental of rooms in an attempt to lower the tax base. In addition, the rule provides examples of types of receipts that are not for the right to occupy a room and are, therefore, not taxable under the HOOT:

If an operator should make a separate and specific charge for the use of bedding or other facilities furnished in connection with the use of a room as living quarters or for sleeping or housekeeping accommodations, the operator's additional receipts from this source are subject to The Hotel Operators' Occupation Tax. However, that tax does not apply to the operator's receipts from selling food, beverages or other tangible personal property, nor to receipts from the selling of tickets to theatre performances or other similar activities, nor to other receipts which are not in any way reasonably connected with or attributable to the renting, leasing or letting of rooms for use as living quarters or for sleeping or housekeeping accommodations: Provided that exemption for such nontaxable receipts cannot be claimed unless supported by proper books and records as provided for in Section 4 of the Hotel Operators' Occupation Tax Act and in Section 480.115 of this Part.

Analysis and Requested Rulings

I. Reward Points Programs

A. Complimentary nights in hotels received through the redemption of reward points are not subject to the HOOT.

As noted above, the rewards point program is a customer appreciation tool used by CLIENT to benefit guests that make repeat visits to its hotels. The members of the program are rewarded with points for each paid stay at CLIENT's hotels. The points may be redeemed for complimentary nights at any of CLIENT's hotels.

The Hotel Operators' Occupation Tax is imposed on the gross rental receipts from the renting of hotel rooms. (35 ILCS 145/3) No gross rental receipts are received from a guest when a complimentary room is received by the redemption of reward points.

The gross rental receipts associated with redeemed points are the gross rental receipts that were paid for rooms on which the points were earned. Tax was imposed at the time the points were earned. Therefore, in the absence of any consideration, gross rent or gross rental proceeds, the room obtained through the redemption of reward points is not subject to the HOOT.

The redemption of points earned by previous paid stays at CLIENT for a complimentary room is no different than CLIENT providing a promotion that offers a third night free when a guest pays for two nights. In such a situation, the consideration received for the three nights is paid by the guest. Similarly, when a guest obtains a free night in exchange for accumulated reward points, the consideration for the free night has been paid by the guest at the time the points were earned.

B. Transactions involving hotels and the Central Fund are not taxable transactions.

As noted above, each hotel submits to the central fund an amount of approximately 4% of the room revenues received from rewards program participants every month. These room revenues have been taxed under the HOOT. In addition, each hotel is credited a certain amount when reward points are used for complimentary stays at the hotel. The credit the hotel receives is a credit of its own money, which offsets the money that it is spending for the marketing program. The money held in the fund is considered to be held on behalf of the individual hotels in proportion to their payments into the fund. Therefore, the transactions involving the central fund and the hotels are not taxable transactions under the HOOT.

When each of CLIENT's hotels submits a monthly contribution to the central fund based on the reward point program members' monthly room revenues, these funds are simply money received from the individual hotels which is accounted for by employees of CLIENT. The cost of accounting for the program comes out of the monies contributed by each hotel.

When each hotel is credited a certain amount when a guest redeems reward points for a complimentary stay at a CLIENT hotel, the credit the hotel receives is a recapture of the hotel's previous contributions. The credit provided to each hotel is not a 'reimbursement' of any kind because, effectively, each hotel is covering the cost of reward point redemptions with its own prior contributions to the fund. The reward point redemption transaction can be analogized to an individual who deposits money into a bank savings account to save for future purchases. When that individual withdraws money from the savings account, it is not a 'reimbursement' from the bank, a third party. Rather, the withdrawal is the individual's reclamation of previously deposited funds to cover current expenses.

Finally, if the reward points program ceases, the money will revert back to each individual hotel. This fact, and the facts detailed above lead to the conclusion that there is no reimbursement from a third party or a person. Therefore, there are no gross rental receipts and no taxable transaction occurring between the CLIENT hotels and the Fund.

II. Early departure charges are not gross rental receipts subject to the HOOT.

As noted above, under the HOOT, the tax is imposed on the gross rental receipts from the rental of rooms. Section 2(6) of the HOOT provides that 'rent' or 'rental' means the consideration received for occupancy. Section 2(3) of the HOOT states that 'occupancy' means 'the use or possession, or the right to the use or possession, of any room or rooms in a hotel'

An early departure charge is not consideration received for occupancy. The payment of an early departure charge does not grant the payee the right to occupancy of a room. On the contrary, an early departure charge is imposed because a person has declined to exercise a right to occupancy for the full term granted previously.

Early departure charges are a form of liquidated damages imposed because of the refusal of a guest to continue occupancy for the full term of a reservation. As a result, by definition, an early departure charge is not gross rental receipts from the renting, leasing or letting of rooms. Therefore, early departure charges are not subject to the HOOT.

Request for a Conference

We respectfully request a personal conference to discuss these matters orally, if the Department believes such may be helpful or if the Department of Revenue may otherwise render a ruling contrary to the our client's position.

If you have any questions or would like to discuss this matter further, please contact me at your convenience.

DEPARTMENT'S RESPONSE:

The Hotel Operator's Occupation Tax Act imposes a tax upon persons engaged in the business of renting, leasing or letting rooms in a hotel at the rate of 5% of 94% of the gross rental receipts from such renting, leasing or letting. See 35 ILCS 145/3. The tax applies to gross receipts received from a person who occupies a room or becomes irrevocably liable to pay rent for the right to occupy a specific room or rooms. See 86 Ill. Adm. Code 480.101(c)(1). The incidence of the tax liability is on the hotel operator, which may seek reimbursement from the hotel room occupant.

Issue I. Hotel Rewards Points Program

Upon review of the representations in your letter, it is the Department's position that the redemption of points for complimentary lodging under the "Reward Points Program" is not subject to tax liability under the Hotel Operators' Occupation Tax Act, 35 ILCS 145/3.

This determination is made based on the representation that reimbursement of the hotel fees for lodging at a CLIENT hotel, when a person uses his or her reward points, comes directly from an account held and owned entirely by CLIENT, and not as reimbursement from a third party. The Hotel Operators' Occupation Tax was remitted by the occupant upon the initial stay, with a percentage of that amount put into a separate fund, wholly owned by CLIENT, for reimbursement of those fees by persons utilizing the rewards points program.

This decision is subject to change should a third party pay any reimbursement of the lodging fees to the CLIENT hotels. The CLIENT hotels, under the representations submitted with this request would not incur Hotel Operators' Occupation Tax liability on the redemption of the reward points.

However, Retailers' Occupation Tax or Use Tax liability may be incurred on tangible personal property transferred incident to a person's stay under the rewards program. Tangible personal property, such as food, drinks, and condiments, would be subject to Retailers' Occupation Tax liability if sold to the occupant. If the tangible personal property were provided to the occupant free-of-charge, then the hotel would incur Use Tax liability as a donor in a gift situation. See 86 Ill. Adm. Code 150.305(c).

Per telephone conference with our office, a determination of the other issues raised in your letter request will be held pending the delivery of additional information, which as indicated, has changed since your original request.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Edwin E. Boggess
Associate Counsel

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